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## THE INCOME TAX LAWS OF VIRGINIA.

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The first income tax levied by the General Assembly of Virginia, which I have been able to discover, will be found in the Acts of 1844. That Act imposed a tax of one per centum on all income in excess of four hundred dollars. In 1847 this law was so amended as to except ministers of the Gospel from its operation. In 1852 the tax bill levied a tax on so much of the income as exceeded \$100.00, at the following rates: one-fourth of one per centum on an excess (of the exemption) amounting to not more than two hundred and fifty dollars; one-half of one per centum if the excess be not more than five hundred dollars; three-fourths of one per centum if the excess be not over one thousand dollars; and one per centum on an excess of more than one thousand dollars. This law excepted from its operation ministers of the Gospel and also those engaged in labor in some mechanical art, trade, handicraft or manufacture.

The first mention of the income tax in our State Constitution is found in Article 4, Section 25 of the Constitution of 1851, which provides:

“The General Assembly may levy a tax on incomes, salaries and licenses; but no tax shall be levied on property from which any income so taxed is derived.”

We find the same provision in Article 4, Section 23, of the Constitution of 1864. However, the members of the Constitutional Convention of 1869 saw fit to make a very great change in the income tax law of this State, and in Article 10, Section 4, of the Constitution, it is provided:

“The General Assembly may levy a tax on incomes in excess of \$600.00 per annum.”

It will be noted that this provision of the Constitution of 1869 was not nearly so restrictive upon the power of the Legislature as were the provisions of the Constitutions of 1851

and 1864. Under the Constitution of 1869 the Legislature could not only levy an income tax on income in excess of \$600.00, but could also tax the property from which the income was derived.

The provision in the Constitution of 1869 with reference to income, above referred to, was embodied in exactly the same language in Section 170 of the Constitution of 1902. However, Section 176 of this Constitution, in prescribing the manner of taxing rail-corporations, provides "that no tax shall be laid upon the net income of such corporations."

In 1904 the income tax law provided that the tax should be 1% on all income in excess of \$600.00. In 1908 the \$600.00 exemption was raised to \$1,000.00, and in 1912 this exemption was again raised to the sum of \$2,000.00.

Prior to the year 1914 the Legislature had seen fit to empower certain municipalities with the authority to impose income taxes for local purposes, but in that year the law was amended so as to provide that no city of less than 65,000 inhabitants, or any town or county should thereafter levy or assess any tax on income for municipal or county purposes, and further expressly provided that any provision of any city or town charter, in conflict with the act was thereby repealed.

It was not until the year 1915 that our State income tax law received any real attention at the hands of the Legislature. In that year a special session of the Legislature was called to revise the tax laws of Virginia. Among the many Acts passed was a comprehensive income tax law. Acts 1915, page 113. This Act might be divided into three parts; the first part defined the word income and prescribed what it should include; the second division dealt with the exemptions, and the third division provided for the deductions; and this classification has been carried into all of the subsequent Acts.

This Act provided for a report of income for State taxation to cover the same period of time which the report of income made for taxation by the United States Government, namely, for the year ending December 31, annually. Prior to this the income tax was assessable as of February 1st, along with other taxes. And this Act further provided that no city,

town or county should thereafter levy any income tax. We may safely say that the plan of this Act will be found in the law now in force, with certain modifications and changes.

Every Legislature that has convened since 1915 has seen fit to make some amendments to this Act, and I will endeavor, in the course of this discussion, to point out these changes.

#### BY WHOM INCOME TAX RETURN IS MADE.

The law provides that every person and corporation, residing or doing business in Virginia, must make an income return. The Act expressly declares that the term "person" shall "mean and include any individual firm or co-partnership", and that the term "corporation" shall mean and include every incorporated company, every joint stock company, and every association having capital stock represented by shares or certificates of stock, organized for profit."

The law provides that where persons reside together, as members of a family, the income of the wife and the income of each child under 21 years of age shall be added to that of the husband or father, or if he be not living, to that of the head of the family, and assessed to him or her. The taxes levied thereon shall be payable by such husband or head of the family, but if not paid by him or her, may be enforced against any person whose income is included in the assessment. This provision appeared in the Acts of 1918 and is in force at present. Further on in this paper, I will take up the question whether or not a wife or child under 21 years of age may make a separate return.

Section 11 of the Tax Bill provides that no income tax shall be imposed on part of the receipts of any public service corporations, which are now subject to a State franchise tax upon such receipts, or on insurance companies which may pay a State license tax on gross premiums, or on State and national banks, banking associations, trust and security companies, or on religious, educational, benevolent and other corporations or associations not organized or conducted for pecuniary profit; and it follows, of course, that these corpora-

tions and associations are not required to make returns of income.

Guardians, trustees, executors, administrators, committees, agents, receivers, curators, conservators and all persons or corporations acting in any fiduciary capacity, must make and render a verified list or return of the amount of income of each person for whom they act, subject to this tax, coming into the custody or control and management, and be subject to all of the provisions of the laws which apply to other individuals; provided, that no deduction or exemption shall be allowed which has been otherwise claimed by or for any person for whom they act.

Income realized by the taxpayer on investments outside of this State is taxable in this State unless the income be derived from business done partly in the State and partly without the State, at offices or other regular places of business within and without this State, when such income is to be reported and taxed as follows:

Persons and corporations doing a part of their business within the State and a part without the State, and having offices or other regular places of business, both within and without the State, shall be taxed only upon such income as is derived from business transacted and property located within the State, which may be determined in either of two ways: first, by an allocation and separate accounting for such income when the books of such person or corporation show income realized from such transactions and property located within the State; or second, such income shall be apportioned and determined as follows: the gross business in dollars of the person or corporation in the State, including the business of production, measured by the cost of production and the business of distribution or sales, measured by the value of gross sales less the cost of production for the year ending December 31, shall be added to the book value of the gross assets on the 1st day of January of the year for which the return is being made, employed in business with this State (with no deduction on account of any encumbrances thereon). The sum so obtained shall be the numerator of a fraction of which the denominator

shall consist of the total gross business, as above defined, of the person or corporation both within and without the State, added to the total and book value of the gross assets on the day last aforesaid, wherever employed in business (with no deduction on account of any encumbrance thereon). The proportion of the entire gross income of such person or corporation which is represented by the fraction so obtained shall be the gross income of such person or corporation returnable for taxation in this State, subject only to the deductions authorized.

The provision of the last paragraph is the substance of an act of the General Assembly found in the Acts of 1918, page 395, and was passed in view of a case arising under the provisions of the previous Act. By an Act approved March 22, 1916 (Acts 1916, page 830), amended by Acts of 1918, page 350, it was provided as follows:

"No income tax nor ad valorem taxes, State or local, shall be imposed upon the stocks, bonds, investments, capital or other intangible personal property heretofore or hereafter owned by corporations organized under the laws of this State, for any tax year during which such corporations do, or have done prior to the passage of this act, no part of their business within this State; and the mere holding of stock-holders' meetings, annual or special, in this State, or the doing of any act or acts, in this State, now or hereafter required by the laws thereof to be done in this State, shall not be construed as doing any business in this State within the meaning of this Act."

The Act of 1916, page 793, imposed an income tax upon "the aggregate amount of income of each person or corporation," including "all profits from earnings of any partnership or business done in or out of Virginia," and also "all other gains and profits derived from any source whatever." Under this Act a tax was imposed by the authorities of Virginia upon the F. S. Royster Guano Co., a domestic corporation, on its income derived from the operation of its plant in Virginia, and also upon its income derived from the operation of its plants outside of Virginia. The Supreme Court of the United States held that the discrimination between those domestic corpora-

tions doing business in Virginia and those domestic corporations doing business both within and without the State, was arbitrary and that, therefore, the tax levied upon the income derived from the operation of its plants outside of the State was forbidden by the equal protection of the laws clause of the Fourteenth Amendment, and was unconstitutional. (*F. S. Royster Co., Inc. v. Virginia*, [U. S.] 17 Advance Sheets 658.) Even before the court passed upon this question, our Legislature remedied this defect by providing for an allocation of the income as set out above.

This Act seems to embrace both "persons and corporations". While it might have been the intention of the Legislature to put individuals and corporations on the same footing in this respect, yet strange results will follow if the Act is held to apply to individuals. It is a fundamental law of taxation that an individual is to be taxed on his income at his domicil. Thus, if A, having his home in Lynchburg, transact all of his business in North Carolina he will be taxed by the Lynchburg authorities, on the income derived from the business done in North Carolina. But (if this Act be construed to apply), and he also has a place of business in Virginia, he will not be taxed by the Virginia authorities on the income derived from the business done in North Carolina. And, furthermore, the constitutional objections raised in the Royster case cannot possibly apply in the case of an individual, for the reason that we have no law exempting a person domiciled in this State, but transacting all of his business outside of the State, from the operation of our tax laws,—as we have in the case of a domestic corporation doing no business in this State.

#### TO WHOM THE INCOME RETURN IS TO BE MADE.

A person, firm or co-partnership must make a return of income to the commissioner of the revenue in whose district they reside or do business.

A corporation chartered under the laws of Virginia (except a corporation which does no part of its business within the State), must make its return of income to the commissioner of the revenue in whose district the principal office of the corpo-

ration is located by the terms of its certificate of incorporation.

A corporation chartered under the laws of a State or country other than Virginia, having a business domicil or domiciles in Virginia, must make return of income to the commissioner of the revenue in whose district the principal office of the corporations in this State is located, whether by express declaration or by such facts and circumstances as will disclose its intention or location of its principal office.

#### WHAT IS INCOME.

This term, as used in the Act, includes:

(a) All rents, including ground rents and rents charge, salaries, wages, fees or compensations, of whatever kind from professions, vocations or other services.

Prior to the year 1918 ground rents and rents charge were expressly excepted from the operation of the income law. These exceptions were eliminated by the Acts of 1918, page 392.

(b) (1) All interest upon notes, bonds or other evidences of debt of every description, including those of other States or counties (except bonds of this State and bonds of the United States), bonds of counties, cities and towns of this and other States, of any corporation, co-partnership, firm or individual; (2) all dividends derived from stock or other evidences of ownership or interest in property (not including dividends paid in stock, and also subject to an exception hereinafter noticed); (3) all royalties derived from mines, patents, copyrights, or the possession or use of franchises or legalized privileges of any kind; (4) and all annuities from invested funds or trusts, with an exception hereinafter pointed out.

(c) (1) All profits derived from the transaction of business; (2) all profits derived from the sale of real or personal estate.

Under the income law of 1916 (Acts 1916, page 793), this sub-section read:

"All profits from earnings of any partnership or business done in or out of Virginia, due and paid or accrued, whether apportioned in any manner or not; and all profits derived from the sale of real or personal estate."



As above pointed out, the first part of this sub-section in so far as it levied a tax on a domestic corporation on its income derived from both its business transacted within and without the State, was held unconstitutional as to the income on the business transacted without the State, in *F. S. Royster Guano Co. v. Virginia, supra*.

(d) The amount of sales of live stock and meats of all kinds, less the actual purchase price of live stock, the sales of which are reported as income.

(e) The amount of sales of wood, butter, cheese, hay, tobacco, grain and other vegetables and agricultural production during the preceding year, whether the same was grown during the year or not. Less all sums paid for labor, fences, feed, fertilizer and seed purchased and used upon the land upon which the vegetables and agricultural productions were grown or produced, and the rent of such land paid by said person, if he be not the owner thereof.

(f) The value of property in excess of \$1,000.00, acquired by gift within the year.

However, property acquired by inheritance, devise or bequest, received during the year, which is subject to the inheritance tax laws of this State, and which has actually been assessed with the inheritance, is not to be reported as income, but the income received from such inheritances, devises or bequests (for example rents, dividends or profits), must be reported as income under the appropriate items.

(g) All other gains and profits derived from any source whatever.

#### INCOME NOT TAXABLE.

As I have shown above, the law taxing income expressly states that nothing contained in the Act shall be construed as imposing an income tax on any part of the receipts of any public service corporation, which are now subject to a State franchise tax upon such receipts or on insurance companies, which may pay a State license tax on gross premiums, or on State and National Banks, banking associations, trust and security companies, or on religious, educational, benevolent and other

corporations or associations of individuals not organized or conducted for pecuniary profit.

It must, however, be borne in mind that taxpayers are taxable upon and must report as income, the dividends on stock and the interest on bonds they own, received from public service corporations, banks, insurance companies, state and national banks, banking associations, etc.

It has been argued with considerable force that dividends derived from stock in State and National Banks are not subject to the State income tax, and the following provisions are cited to sustain the contention: Section 11 of the Tax Bill which declares that "nothing herein contained shall be construed as imposing an income tax on State and National Banks," etc.; Section 17 of the Tax Bill which provides that bank stock shall be taxed in the hands of the stockholders at its "*actual value*," which shall be ascertained by "adding together its *capital, surplus and undivided profits*." In view of these provisions it is claimed that an income tax on the dividends is in reality levied along with the tax on the stock, because the profits (from which the dividends are declared) are taxed as a part of the stock, and that it would be inequitable to tax this income twice. However, it would seem that such dividends are taxable, inasmuch as the income law expressly declares that "all dividends from stock" are taxable as income, and does not expressly exempt bank stock.

Salaries, wages and other compensations received from the United States, by officers or employees thereof, are not taxable as income, but the income of such officers and employees, from other sources, is taxable. In this connection I would call your attention to the opinion of the Attorney General of Virginia, to the effect that the salaries, wages and compensations received by officials and employees of the railroad, telegraph and telephone companies, while under the control of the United States Government, are not exempt from taxation under the provision above set out. It is true that these corporations were for a time controlled and operated by the United States Government, yet the ownership of corporations was still invested in the stockholders, and the salaries and wages of the employ-

ees were paid from the earnings of the corporations and not from taxes and revenues of the United States Government. However, some of the State officials have ruled otherwise, and I am advised that in certain cities of the State this income has not been taxed.

Pensions received from the United States or the State of Virginia are not taxable as income.

Interest received on bonds of this State and bonds of the United States is not to be reported as income.

In reporting the income from the sales of live stock, a deduction of the actual purchase price of the live stock, the sales of which are reported as income, is authorized.

Dividends paid in shares of stock are not taxable as income, by an express provision of the Statute.

The value of property acquired by gift within the year, not exceeding the sum of \$1,000.00, is not taxable.

As heretofore stated, all annuities from invested funds or trusts are taxable as income, but the proceeds of life insurance companies paid upon the death of the person insured or payments made by or credited to the insured on life insurance, endowment or annuity contracts, upon the return thereof to the insured at the maturity of the term mentioned in the contract or upon surrender of the contract, shall not be included as income.

#### EXEMPTIONS.

There is exempt from taxation under this schedule income as follows:

- (a) To an individual the sum of twelve hundred dollars.
- (b) To husband and wife living together the sum of eighteen hundred dollars.

The requirement that the husband and wife be "living together" made its appearance in the Acts of 1918.

- (c) For each additional person who is actually supported by and is entirely dependent upon the taxpayer for support, the sum of two hundred dollars.

Suppose the husband or father includes in his income report the income of his wife, \$1,300.00, and the income of a child,

under twenty-one years of age, \$1,300.00. Should the husband deduct \$1,800.00 as the exemption for himself and wife and \$200.00 as the exemption for the child, making a total exemption of \$2,000.00, or should he be exempt in addition to the \$2,000.00, \$1,200.00 each on account of the wife and child? On this question the Attorney General of Virginia has ruled that the husband is entitled to an exemption of only \$2,000.00, but he adds that should the wife elect to make a separate return for herself, she would be entitled to an exemption of \$1,200.00. While it seems fair that the wife should be allowed to make a separate return (and be entitled to the exemption of \$1,200.00), yet a careful reading of the Statute indicates that this cannot be done. The Statute provides:

“In computing said exemptions and the amount of taxes payable by persons residing together as members of a family, *the income of the wife and the income of each child under twenty-one years of age shall be added to that of the husband or father.*” (Italics ours.)

If the term “shall be added” is mandatory, neither the wife nor the child should be allowed to make a separate return. The tax officials of the State seem to agree that the child cannot make a separate return. It is my opinion, that under the wording of the Statute, the child should not be allowed to make a separate report of income, and, as the provision of the Statute applicable to the child is also applicable to the wife, the latter should not be allowed to make a separate income return (and be entitled to the exemption of \$1,200.00).

Under the Act of 1916 the exemption of \$200.00 for a dependent person was allowed only “for each unmarried natural or legally adopted child under the age of twenty-one years.” It is provided in Section 2303 of the Code 1919 that “where deductions are allowed by law in the assessment of income or other taxes on account of an unmarried child or children, the same allowances shall be made in the case of a child or children legally adopted as for natural children.”

Under the present Act this exemption of \$200.00 is allowed even though the dependent be not a child of the taxpayer, but it should also be noted that this exemption is only permitted

in a case where the person is wholly dependent and is also actually supported by the taxpayer. Both requirements must concur.

The income law also provides that guardians, trustees, etc., shall be allowed the same exemptions for the persons for whom they act as the case of other individuals.

Only individuals are entitled to the benefit of these exemptions, and, therefore, they cannot be claimed by corporations, joint stock companies and co-partnerships.

#### DEDUCTIONS.

Persons and corporations in reporting income shall be allowed the following deductions:

(a) Payments made within the year for salaries of officers, wages of employees and a reasonable allowance for services of co-partnership members of a firm actually rendered in producing such income, but no deduction shall be made for any amount paid for personal services unless there be reported the name and address and the amount paid each such officer, employee or co-partner residing within the State, to whom the sum of \$1,000.00 or more shall have been paid during the assessment year.

This deduction first appeared in the Acts of 1918 and is in force at the present time.

(b) The necessary expenses actually paid within the year in carrying on the profession, occupation or business from which the income is derived, not including personal living or family expenses.

(c) A reasonable annual allowance for depreciation by use, wear, tear and obsolescence of the property from which the income is derived, on the basis of its cost in cash or the equivalent in cash; but no deduction shall be made for any amount of expenses of restoring the property or making good the exhaustion thereof for which an allowance is or has been made.

This deduction is first found in the Acts of 1918.

(2) But no deduction shall be allowed for any amount paid for books, tools, instruments, appliances, machinery, furniture or fixtures, buildings, permanent improvements or betterments

or other taxable property purchased, whether used in connection with the business or not. The income law of 1916 contained the same provision, except that the words "buildings, permanent improvements or betterments", were not in that Act.

(d) Losses of property actually sustained during the year and not compensated for by insurance or otherwise.

This deduction was allowed by the Acts of 1916, but with the added provision that the loss must have occurred in the transaction of some lawful business.

(e) All debts due the taxpayer actually ascertained to be worthless and actually charged off within the year, provided the same are listed showing the amount then due and the names of the debtors.

The qualification that the names of the debtors must be shown, etc., is new, having been first inserted in the income tax law of 1918.

(f) Sums paid by the taxpayer within the year, for taxes imposed by any State of this Union or possession thereof, upon the property, profession, occupation or business from which the income hereby taxed is derived; but not including assessments for local improvements or inheritances wherever imposed.

This provision does not permit a deduction of *any* taxes paid, (1) the United States Government, or (2) any income tax paid the State of Virginia, or (3) any assessments for local improvements, or (4) inheritance taxes wherever imposed. All other taxes upon the property, profession, occupation or business *from which the income is derived*, are allowable deductions. It should be carefully observed that taxes upon property from which no income is derived, (for example a dwelling house or garage) cannot be deducted.

Under the provisions of the State income tax law, prior to its amendment by the Legislature at its session in 1918, the taxpayer was authorized to deduct *all taxes* paid by him, but for some reason the Legislature of 1918 saw fit to limit and specify the taxes which may be deducted, and these limitations are still in effect.

(g) Dividends or profits received from stock or any interest in any corporation or co-partnership the income of which shall have been assessed under the provisions of this Act are not taxable as income, provided that when only a part of the income of any corporation or co-partnership shall have been assessed under this Act only a corresponding part of the dividends or profits received therefrom shall be deducted. Acts 1918, page 392.

Under the Act of 1916 each individual, whose income was taxable under this section of the Act, was required to report the profits and dividends received from any business in which he was interested or owned stock, and was also required to show the source from which the profits and dividends were received and the amount received; but he was not taxable on such profits and dividends provided they were reported for assessment by the person or corporation conducting the business; otherwise the individual was taxable on such profits and dividends as income.

By comparing these two Acts, it will be seen that the Act of 1916 required the taxpayer to show in his income return, *first*, the names of the co-partnerships or corporations in which he had an interest or owned stock, and, *second*, the amount of income derived from such interest or stock, while the Act of 1918 does not seem to require the taxpayer to show in his return the source from which the income is derived, but only requires him to state the amount of the income. However, the Auditor of Public Accounts, in preparing the form for the State income return, has provided a space on which the taxpayer is to state the name of the co-partnership or corporation, its address and the amount of income from that source.

(h) All interest paid within the year on existing indebtedness: provided that the amount so deducted by any corporation or co-partnership shall not exceed one-half of its interest-bearing indebtedness and its paid up capital stock, or if no capital stock, the amount shall not exceed the sum of its net worth and one-half of its interest-bearing indebtedness as both stood at the close of the year.

This provision allowing interest to be deducted was first enacted in 1918, and is in force at the present time.

(i) All tornado, casualty and fire insurance premiums due and paid on property in this State during the year.

Prior to the year 1918 only fire insurance premiums could be deducted.

(j) The actual amount paid during the year for repairs to and maintenance of buildings, the rent of which is reported as income.

#### OFFICERS NOT TO MAKE KNOWN AMOUNT OF RETURN.

Section 10 of the Tax Bill requires the Auditor of Public Accounts to furnish the commissioners of the revenue with the necessary forms for the assessments of the income and he is also required to furnish the income books. This section further provides that such returns and books shall be kept safely by the commissioner under lock and key, except when in his personal possession, and shall not be inspected by any person not officially entitled to inspect them, and the commissioner shall not give to any person, except to some other officer, authorized to receive the same, by law or special order of a court of competent jurisdiction, any information regarding such returns.

The treasurer of the several counties and cities of the State and the Auditor of Public Accounts are required to keep under lock and key, all income returns of individuals paying the income tax, and shall not permit the same to be inspected, except by tax officers of this State; provided, that in the event the United States Government or any other State allows the officers of this State to examine its income tax returns, then this State shall allow an inspection of its income tax returns by proper officials of the United States Government, or by the proper officials of such other State, whose official duties require them to make such inspection; nor shall they give any information to any person other than those hereinbefore mentioned, except in obedience to a decree or order of a court of competent jurisdiction.



## THE RATE OF TAXATION.

By an act approved September 5, 1919 (Acts 1919, page 69), it is provided that the tax upon income shall be one per centum on the amount of taxable income up to \$3,000.00, and two per centum on amount of taxable income in excess of \$3,000.00.

For many years prior to the passage of this Act the rate had been one per centum on the amount of taxable income.

ROBERT WHITEHEAD.

*Lynchburg, Va.*